



87-SBE-033

BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
) No. 82A-1826-DB
 HOOKER INDUSTRIES, INC.)

Appearances:

Far Appellant: Walter Tribbey
Attorney at Law

For Respondent: Donald C. McKenzie
Counsel

O P I N I O N

256661/ This appeal. is made pursuant to. section
of the Revenue and Taxation Code from the
action of the Franchise Tax Board on the protest of
Hooker Industries, Inc., against proposed assessments of
additional franchise tax in the amounts of \$15,062 and
\$2,245 for the income years ended June 30, 1973, and
June 30, 1974, respectively.

I/ Unless otherwise specified, all section references **are** to sections of the Revenue and Taxation **Code** as in effect for the income years in issue.

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The issue in this appeal is whether appellant and its wholly owned subsidiary, Superior Plastics, Inc., were engaged in a single unitary business during the appeal years.

Appellant was incorporated in California in 1966 for the purpose of manufacturing and selling high performance exhaust systems for racing cars. Thereafter, appellant expanded its product line to include additional parts and accessories for automobiles, motorcycles, and snowmobiles. In 1972, appellant decided to broaden its activities further in order to facilitate a planned initial public offering of its stock. As part of this plan, appellant bought the assets of a water ski manufacturing business in January 1973 and the stock of Superior Plastics, Inc., an Oregon boat manufacturer, in February 1973. For its income years ended June 30, 1973, and June 30, 1974, appellant filed its franchise tax returns on a combined report basis with Superior. After auditing those returns, however, respondent determined that appellant and Superior were not engaged in a single unitary business during this period, and it issued the proposed assessments now before us.

A taxpayer which derives income from sources both within and without California is required to measure its California franchise tax liability by its net income derived from or attributable to California sources. (Rev. & Tax. Code, § 25101.) Even if a taxpayer does business solely in California, its income is derived from or attributable to sources both within and without California where the taxpayer is engaged in a multistate unitary business with one or more affiliated corporations. In such a case, the amount of income attributable to California sources must be determined by applying an ~~ap~~partionment formula to the total income derived from the combined unitary operations of the affiliated corporations. (See Edison California Stores, Inc. v. McColgan, 30 Cal.2d 472 [183 P.2d 16] (1947).)

Respondent's determination is presumptively correct, and appellant bears the burden of proving that it is incorrect; i.e., that the two companies did constitute a unitary business. The existence of a unitary business is established if either of two tests is met. (Appeal of P. W. Woolworth Co., Cal. St. Bd. Of Equal., July 31, 1972.) The California Supreme Court has determined that the existence of a unitary business is definitely established by the presence of: (1) unity of ownership; (2) unity of operation as evidenced by central.

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purchasing, advertising, accounting, and management-divisions: and (3) unity of use in a centralized executive force and general system of operation. (Butler Bros. v. McColgan, 17 Cal.2d 664, 678 [111 P.2d 3341 (1941)], affd., 315 U.S. 501 [86 L.Ed. 991] (1942).) The court has also stated that a business is unitary when the operation of the portion of the business done within California is dependent upon or contributes to the operation of the business outside California. (Edison California Stores, Inc., v. McColgan *supra*, 30 Cal.2d at 481.)

The appellant seems to base its case on the contribution or dependency test. In support of its position, appellant places particular emphasis on the executive and managerial control which it exercised over Superior at **all times** after **Superior was** acquired. The record reveals that, with the exception of James Lloyd, Superior's founder, all of Superior's officers and directors were replaced by appellant's **officers** and directors **as soon as** the acquisition was completed. Appellant also took steps to **assume** financial control of Superior's affairs. Employees of appellant, for example, supervised the collection of Superior's past-due accounts, and all of Superior's purchases above a nominal amount had to be approved by appellant's executives. Appellant also states that its production and inventory control manager took over all such functions for Superior soon after the acquisition.

Other **examples** of alleged contribution and dependency include loan guarantees of **up to** \$2 million **which** appellant undertook in support of Superior's line of credit with its Oregon bank. By December 20, 1973, appellant had **guaranteed** bank loans to Superior in the total amount of \$644,000. Sometime in 1973, appellant also took over Superior's advertising and brought samples of Superior's boats to **appellant's** Ontario, California, headquarters for study by appellant's engineers. **These** engineers began to redesign and reengineer all of Superior's boats, as well as to prepare new manufacturing specifications for the boats. They also conducted research into the development of an ocean-racing boat, a product not then included in Superior's product line. Finally, appellant notes that Superior's employees were added to appellant's profit-sharing **plan** and that Superior was added to appellant's insurance policies. These actions, however, were taken just three days before the end of the appeal period, in the case of the **profit-sharing** plan, and one month after the end of the last appeal year, in the case of the insurance policies.

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When a corporate taxpayer invests in distinct business operations and seeks to prove the existence of a single unitary business, it must produce sufficient **evidence** to show that the unitary factors relied upon resulted in a functionally integrated enterprise rather than merely a group of investments whose business operations are unrelated. (Appeal of J.B. Torrance, Inc., Cal. St. Bd. of Equal., May 8, 1985; Appeals of Santa Anita Consolidated, Inc., et al., Cal. St. Bd. of Equal., Apr. 5, 1984.) The evidence appellant has offered falls short of proving the existence of a functionally integrated enterprise. The executive **and managerial control** mentioned by appellant, for example, related primarily to financial controls over Superior's operation rather than to any operational integration between the two corporations. This sort of managerial control lacks unitary significance **because** it reveals nothing more than the owner's interest in **overseeing** its assets. (Appeal of Mole-Richardson Co., Cal. St. Bd. of Equal., Oct. 26, 1983; Appeal of Hollywood Film Enterprises, Inc., Cal. St. Bd. of Equal., Mar. 31, 1982.) Indeed, appellant's own corporate minutes show that appellant's directors were **primarily** concerned with protecting appellant's investment in Superior in the face of quickly **deteriorating** business conditions which led to substantial operating losses and then to Superior's bankruptcy in 1975.

The other allegedly unitary connections relied **upon** by appellant similarly lack any tendency to prove the existence of a single integrated economic enterprise. (See Appeal of Saga Corporation, Cal. St. Bd. of Equal., June 29, 1982.) **Most** of them, such **as** the collection, purchasing, **loan** guarantee, and inventory control items, fall into the category of financial-type controls, which do nothing to distinguish the operation of a unitary business from the mere management of one's assets. (See Appeal of C. B. Stuart, Inc., Cal. St. Bd. of Equal., Nov. 14, 1984.) Other items, such **as** the additions of Superior to appellant's insurance policies **and profit-sharing** plan, occurred either after the end of the appeal period or very close to the end and, thus, have little or no relevance to the existence of a **unitary** business during the years at issue. (Appeal of Hollywood Film Enterprises, Inc., supra.) The one item which had the potential to establish a significant unitary connection, the engineering research and development conducted for Superior by appellant's engineers, has not been developed sufficiently to show precisely **when** this work was done or whether it actually led to an operational **interrelation-**

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ship of any substance between the two companies. Even if this one item had been developed, however, it would not have been sufficient, by itself, to establish the existence of a functionally integrated enterprise.

For the above reasons, we **conclude** that appellant has not established that it was engaged in a single unitary business with Superior. Respondent's action in this matter, therefore, will be sustained.

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O R D E R

Pursuant to the views expressed in the opinion
of the board on file in this proceeding, and good cause
appearing therefor,

IT IS HEREBY ORDERED & **ADJUDGED** AND **DECREED**,
pursuant to section 25667 of the Revenue and **Taxation**
Code, that the action of the Franchise Tax Board on the
protest of Hooker Industries, Inc., against **proposed**
assessments of additional franchise tax in the amounts of
\$15,062 and \$2,245 for the income years ended **June 30**,
1973, and June 30, 1974, respectively, be and the **same** is
hereby sustained.

Dune at Sacramento, California, **this** 7th day
of May, '1987, by **the** State **Board of Equalization**,
with Board Members Mr. Collis, Mr. Dronenburg, Mr. Bennett,
Mr. Carpenter and Ms. Baker present.

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| <u>Conway H. Collis</u> | Chairman |
| <u>Ernest J. Dronenburg, Jr.</u> | Member |
| <u>William M. Bennett</u> | Member |
| <u>Paul Carpenter</u> | Member |
| <u>Anne Baker*</u> | Member |

*For Gray Davis, per Government Code section 7.9